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# QUESTIONING THE PER SE STANDARD IN CASES OF CONCERTED MONOPSONY

*Alan Devlin\**

## I. INTRODUCTION

Four CEOs of rival companies hold a secret meeting in which they decry the crushing and ruinous competition between them, the ever-falling profit margins, and the seemingly endless cycle of price-cutting. The solution? The four covertly agree to increase prices by 10 percent right away and by a further 10 percent a week later. Sure enough, prices rise, profitability is up, and the CEOs are happy—until the antitrust enforcement agencies discover the deal. Under the competition laws, the four CEOs have committed a per se violation of the Sherman Act<sup>1</sup> and are likely to face considerable penalties.<sup>2</sup> Such factors as desperation in the face of dwindling profits and increased competition fall on deaf ears, for the CEOs' joint act of fixing prices is illegal in and of itself.<sup>3</sup> This should be far from surprising, for the principle that concerted monopoly power over price is illegal constitutes the most fundamental tenet of antitrust law.<sup>4</sup>

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1. 15 U.S.C. §§ 1-7 (2000 & Supp. 2004). *See, e.g.*, *United States v. Trenton Potteries Co.*, 273 U.S. 392, 398 (1927) (holding that minimum, horizontal price-fixing is illegal per se); *Arizona v. Maricopa County Med. Soc'y*, 457 U.S. 332, 348 (1982) (holding that even maximum, as opposed to minimum, horizontal price-fixing is subject to the per se ban).

2. *See* Clayton Antitrust Act § 4, 15 U.S.C. § 15 (2000) (granting injured parties right to sue for treble damages).

3. *See, e.g.*, *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 220-21 (1940).

4. *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209, 223 (1993) (referring to "the antitrust laws' traditional concern for consumer welfare and price competition"); *Reiter v. Sonotone Corp.*, 442 U.S. 330, 343 (1979) (holding that the Sherman Act creates a "consumer welfare prescription"); ROBERT BORK, *THE ANTITRUST PARADOX* 427 (Free Press 2006) (1978) (arguing that the sole purpose of the antitrust laws is to promote consumer welfare); William J. Kolasky, Deputy Assistant Att'y Gen., Antitrust Div., U.S. Dept. of Justice, U.S. and EU Competition Policy: Cartels, Mergers, and Beyond (January 25, 2002) (transcript available at <http://www.usdoj.gov/atr/public/speeches/9848.pdf>) (noting that "the ultimate goal of any sound competition policy must be consumer welfare, which competition advances through lower prices,

A more interesting question concerns the proper status of concerted *monopsony* power. Monopsony is the converse of monopoly—it involves buyer, as opposed to seller, clout. Hence, consider the opposite situation of that presented above. Imagine now that the four CEOs clandestinely meet in desperation following ever-rising input costs. The components they buy from their suppliers have become so expensive that the CEOs see their costs of production skyrocketing, the prices they charge their customers increasing, and their profits dwindling. Accordingly, they agree to refuse to purchase their inputs at current prices and instead will agree to purchase them only if the price charged is reduced by 20 percent. The manufacturers of these inputs have no other use for their produce and are forced to reduce their price. After the agreement, the four companies find their total costs of production sharply reduced and their profitability back up. Are the CEOs and the companies they represent guilty of a per se breach of the antitrust laws? Is concerted monopsonistic power over input-prices necessarily illegal?

The answer is not immediately apparent, either as a matter of law or theory. The courts are currently split on the question of whether per se illegality should attach to concerted instances of monopsonistic price-setting.<sup>5</sup> On the theoretical level, unilateral or concerted distortion of market outcomes by firms is invariably understood to be harmful to allocative and productive efficiency.<sup>6</sup> Ultimately, antitrust law focuses on consumer welfare as the sole consideration in assessing the competitive significance of business acts. Consumer injury typically flows from artificially produced market distortions and, so, practices that cause such distortions are struck down.

Yet, in the context of monopsonistic control, harm to consumers is not immediately evident. Instead of prices going up, they are forced down. At an intuitive level, one might imagine that such cost-reductions will necessarily be passed onto consumers and, on that basis, should be presumptively deemed legal. Interestingly, however, economics can show that such cost-reductions will rarely be passed onto consumers.

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higher output and enhanced innovation”); Howard H. Chang et al., *Has the Consumer Harm Standard Lost its Teeth?* 1 (Massachusetts Institute of Technology, Sloan School of Management Working Paper No. 4263-02, 2002) (“[C]onsumer welfare is the fundamental standard for evaluating competitive effects.”), [http://ssrn.com/abstract\\_id=332021](http://ssrn.com/abstract_id=332021). See generally Robert H. Lande, *Consumer Choice as the Ultimate Goal of Antitrust*, 62 U. PITT. L. REV. 503 (2001).

5. Compare *Balmoral Cinema, Inc. v. Allied Artists Pictures Corp.*, 885 F.2d 313, 317 (6th Cir. 1989), *Addamax Corp. v. Open Software Found., Inc.*, 888 F. Supp. 274, 280-81 (D. Mass. 1995), and *Kamine/Besicorp Allegany L.P. v. Rochester Gas & Elec. Corp.*, 908 F. Supp. 1194, 1203 (W.D.N.Y. 1995), with *Telecor Commc'ns, Inc. v. Sw. Bell Tel. Co.*, 305 F.3d 1124, 1133-34 (10th Cir. 2002), *United Airlines, Inc. v. U.S. Bank N.A.*, 406 F.3d 918, 925 (7th Cir. 2005), and *Khan v. State Oil Co.*, 93 F.3d 1358, 1361 (7th Cir. 1996), *vacated*, 522 U.S. 3 (1997).

6. See, e.g., DENNIS W. CARLTON & JEFFREY M. PERLOFF, *MODERN INDUSTRIAL ORGANIZATION* 634-37 (4th ed. 2005) (discussing the goals of antitrust law).

Nevertheless, can it be accurately said that firms' monopsonistic reduction in input costs is invariably objectionable and will never enhance consumer welfare in downstream markets?

This Article explores the application of the per se standard to instances of concerted monopsony power in oligopsonistic contexts.<sup>7</sup> A minority of jurisdictions to consider the phenomenon has held that market power on the selling side in downstream markets is a prerequisite to antitrust liability. This minority position has been discredited by the majority of courts and academics to consider the issue. These commentators and judges have forcefully argued, and held, that per se illegality should attach.

Yet, it will be shown below that faithful adherence to the underlying principles of both the per se standard and the consumer welfare imperative suggest that the minority approach may be the technically correct one. Importantly, though, this observation does not render the minority approach laudable, for the monopsony context suggests that dogmatic adherence to a strict notion of consumer welfare may be improper. Accordingly, this Article seeks to address the question of how "anticompetitive" ought to be defined.

## II. DETERMINING THE SCOPE OF PER SE ILLEGALITY

In Part II.B, *infra*, it will be shown that concerted monopsony power is capable of being anticompetitive and harmful. Accordingly, circumstances clearly exist in which such concerted conduct should be deemed illegal. The question that this Article seeks to address, however, is whether such condemnation is *always* appropriate. The legal standard used to label such categorical denunciation is that of per se illegality. In order to determine whether concerted monopsony power over input-prices ought to be subjected to this legal standard, then, it is necessary to consider the circumstances in which the standard is applied.

### A. THE PER SE STANDARD

Under the antitrust laws, business practices construed as inherently and inescapably anticompetitive are struck down under a per se standard of illegality. The Supreme Court has identified such practices as those with pernicious effect and little or no redeeming virtue.<sup>8</sup> Alternatively, per se illegality is justified where a business practice's "nature and necessary

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7. An oligopsony is a market structure characterized by concentration on the purchasing side of the market with a relatively large number of sellers. This generally arises in input market where a limited number of manufacturers compete to acquire factors of production. JEFFREY M. PERLOFF, MICROECONOMICS 521 (2d ed. 2001).

8. See, e.g., *N. Pac. Ry. Co. v. United States*, 356 U.S. 1, 5 (1958).

effect are so plainly anticompetitive that no elaborate study of the industry is needed to establish their illegality."<sup>9</sup> In general, then, "[p]er se rules of illegality relate to conduct that is manifestly anticompetitive."<sup>10</sup> Importantly, however, the Supreme Court has expressed its reluctance to employ the per se standard where the economic result of the practice is not immediately obvious.<sup>11</sup>

The practices identified as being worthy of such treatment are limited in number and clear in effect. The benefit of a per se standard involves efficiency—if a majority of practices will be harmful, it saves on costs to declare all such practices illegal even if some manifestations of the phenomena at issue may be benign or enhance of consumer welfare. Nevertheless, the costs thereby saved must be weighed against the harm of declaring a benign practice illegal.<sup>12</sup>

Accordingly, a critical determination in identifying those practices worthy of per se condemnation involves the likelihood of Type I and II errors. A Type I error arises when a proper null hypothesis is erroneously rejected.<sup>13</sup> As applied to the current context, per se illegality will give rise to Type I errors when procompetitive business practices are struck down. A Type II error occurs where an improper null hypothesis is mistakenly accepted.<sup>14</sup> Type II errors will not arise under a per se standard, for every anticompetitive manifestation of the practice at issue will be held illegal.

As classically expressed by Judge Easterbrook, anticompetitive practices erroneously permitted will be eroded by the mechanisms of the free market; procompetitive activities mistakenly outlawed have their benefit lost forever.<sup>15</sup> In short, the label of per se illegality must be applied sparingly and only where the business practices in question are "pernicious" and lack any "redeeming virtue";<sup>16</sup> that is, where the possibility of Type I error is slight. The crucial question, then, is whether instances of concerted monopsonistic power possess some redeeming virtue and, if so, whether the extent of those benefits should preclude application of the per se standard.

## B. DEFINING "ANTICOMPETITIVE"

The first step in assessing whether monopsonistic conduct is purely

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9. Nat'l Soc'y of Prof'l Engineers v. United States, 435 U.S. 679, 692 (1978).

10. Cont'l T.V. v. GTE Sylva, 433 U.S. 36, 49-50 (1977).

11. See, e.g., State Oil Co. v. Khan, 522 U.S. 3, 10 (1997).

12. See, e.g., Cont'l T.V., 433 U.S., at 50 n.16.

13. For an example of a Type I error analysis being applied to legal reasoning, see Ballew v. Georgia, 435 U.S. 223, 234 (1978).

14. For an example of a Type II error analysis being applied to legal reasoning, see *id.*

15. Frank H. Easterbrook, *The Limits of Antitrust*, 63 TEX. L. REV. 1, 15 (1984).

16. See, e.g., N. Pac. Ry. Co. v. United States, 356 U.S. 1, 5 (1958).

pernicious, or carries some form of concomitant benefit, is to identify a normative standard. Without one, defining “anticompetitive” becomes a futile task.

Although antitrust law has been continuously evolving since the enactment of the Sherman Act<sup>17</sup> in 1893, consumer welfare has emerged as the fundamental standard informing competition policy.<sup>18</sup> According to this norm, only where a concerted or unilateral activity reduces output and raises price in a relevant market, thereby harming consumers, should the activity be struck down. Thus, per se illegality is appropriate only where consumer welfare will invariably be diminished.

Interestingly, though, the modern focus on consumer welfare as the *sole* standard by which to judge claims of anticompetitive behavior does not sit easily with the jurisprudence of the Supreme Court. Time and again, the Court has referred to the process of competition that must be protected.<sup>19</sup> While consumer harm is universally cited as being worthy of condemnation, it is rarely the lone consideration.<sup>20</sup> Although the Court’s modern proclamation that antitrust law does not protect individual competitors greatly supports a consumer-focused competition regime,<sup>21</sup> it does not remove from consideration other factors that may be viewed as relevant. Foremost among these must surely be a demonstrable restriction in market output of the type witnessed when sellers collude to depress the market-clearing price.

Fortunately, the Supreme Court’s focus on protecting the process of competition is almost always reconcilable with the maximization of consumer welfare. Accordingly, and given the considerable reverence granted the consumer norm by the enforcement agencies and courts today, the Chicago School’s focus on consumer welfare has become the *de facto* standard.

A valid question, then, is to ask what kind of harms should be cognizable as injurious to consumers. Today, the Chicago<sup>22</sup> and post-Chicago<sup>23</sup> Schools of antitrust jurisprudence have influenced the courts and enforcement agencies to the degree that now only elevated prices and diminished output in consumption markets are typically objectionable.<sup>24</sup>

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17. Act of July 2, ch. 647, 26 Stat. 209 (1890) (codified as amended at 15 U.S.C. §§ 1-7 (2000)).

18. See *supra* text accompanying note 4.

19. See *infra* text accompanying note 79.

20. See *infra* text accompanying note 79.

21. See, e.g., *Brown Shoe Co. v. United States*, 370 U.S. 294, 344 (1962) (“It is competition, not competitors, which the Act protects.”).

22. See generally Richard A. Posner, *The Chicago School of Antitrust Analysis*, 127 U. PA. L. REV. 925 (1979).

23. See generally Herbert Hovenkamp, *Post-Chicago Antitrust: A Review and Critique*, 2001 COLUM. BUS. L. REV. 257 (2001).

24. See, e.g., Kolasky, *supra* note 4.

This consumer-centric philosophy manifests itself not only in the substantive rules governing business practices, but also in the standing prerequisite for bringing suit. According to this rule, a plaintiff must have suffered an "injury of the type the antitrust laws were intended to prevent and that flows from that which makes the defendants' acts unlawful."<sup>25</sup> More specifically, harm to the competitive process, rather than harm to individual competitors, must be demonstrated for a plaintiff to have standing. The *raison d'être* of this requirement is the consumer welfare imperative. As explained by the Supreme Court, "Low prices benefit consumers regardless of how those prices are set, and so long as they are above predatory levels, they do not threaten competition. Hence, they cannot give rise to antitrust injury."<sup>26</sup>

Armed with the consumer welfare standard of harm, it is easy to see why the concerted exercise of *monopoly* power meets the *per se* standard. A cartelized industry's higher prices do more than increase the sellers' profitability—they harm society. By raising the price of a good beyond the marginal cost of production—the price that would exist under perfect competition—some consumers who value the good at a level equal to, or greater than, the cost to society of producing it are nevertheless denied access to it. As a result, there is a loss in value as some consumers satisfy their demand by switching to goods that require more of society's scarce resources to produce.<sup>27</sup> As expressed in economic terms, sellers typically face downward-sloping demand curves so that their concerted action to increase the purchase price results in a restriction in output. This creates what economists refer to as deadweight loss.<sup>28</sup>

Accordingly, concerted monopoly power is typically pernicious. As there are few, if any, instances in which the concerted exercise of monopoly price power is apt to increase consumer welfare,<sup>29</sup> there is no significant redeeming virtue. Thus, monopoly price-fixing is properly condemned under the *per se* standard.

So, what of concerted monopsony power? As the mirror image of concerted monopoly power, one would automatically assume that similar *per se* treatment should follow. Indeed, this is the path taken by the majority of courts to consider the question.<sup>30</sup> Nevertheless, the ensuing economic analysis will demonstrate how the effects of monopsony and

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25. *Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977).

26. *Atl. Richfield Co. v. U.S. Petroleum Co.*, 495 U.S. 328, 340 (1990).

27. See RICHARD POSNER, *ECONOMIC ANALYSIS OF LAW* 278 (Aspen 6th ed. 2003) (1972).

28. See CARLTON & JEFFREY M. PERLOFF, *supra* note 6, at 95-96.

29. *But see* RICHARD POSNER, *ANTITRUST LAW* 20 (2d ed. 2001) (discussing the possibility that monopoly may spur greater levels of innovation than competition).

30. See, e.g., *Khan v. State Oil Co.*, 93 F.3d 1358, 1361 (7th Cir. 1996) ("[M]onopsony pricing . . . is analytically the same as monopoly or cartel pricing and so treated by the law.") (Posner, J.), *vacated*, 522 U.S. 3 (1997).

monopoly are readily distinguishable and that the role of the consumer must be approached in a distinct manner. Specifically, the consumer welfare-reducing effect of monopsony power is unquestionably more attenuated than is the case with seller-side cartels. This constitutes the source of the tension involved in applying the consumer welfare standard in this context, for distortion of market outcomes is immediately apparent, though a showing of elevated prices is somewhat more elusive.

This Article proceeds by economically assessing the phenomenon of monopsony power in order to determine the circumstances in which consumers may, and may not, be harmed, in addition to identifying societal harms of a type arguably not encapsulated by a strict interpretation of the consumer welfare standard. Armed with the foregoing knowledge, it will be possible to consider the case law that has considered the question of concerted control over price in the oligopsonistic context. The counter-intuitive nature of consumer harm potentially flowing from reduced input costs will be seen to have led some courts astray. Meanwhile, other courts have struggled to reconcile the possible absence of consumer harm in some instances with the market distortion in every monopsony case. Ultimately, this will lead to a suggested rule for courts seeking to advance the consumer welfare standard only, in addition to a proposal for the widening of that standard to incorporate the type of ancillary harms with which antitrust should arguably be concerned.

### III. THE ECONOMICS OF MONOPSONY

From the consumer welfare perspective, the position that the economic consequences of monopsony are equivalent to those of monopoly is too facile. Unlike in the case of monopoly, there are two markets with which one ought to be concerned. In the input market, the exercise of monopsony power indisputably reduces the cost of the input. Where the input elasticity of supply is less than completely inelastic, moreover, some reduction in the quantity of the input purchased will also take place. However, unlike with monopoly, there is a second, downstream market that must be considered. It is here that the question of the competitive significance of monopsony power will be answered, for this is where consumer welfare issues are triggered.

#### A. THE WORKINGS OF MONOPSONY POWER

A monopsonist—or a group of firms acting in concert to achieve the same position—possesses power over the price at which the purchased good clears. While a purchaser in a competitive market would be a price-taker, the monopsonist chooses the price-quantity pair on the market supply curve where the marginal value of the input equals the marginal cost of



consuming the unit.<sup>31</sup> More technically, the monopsonist will purchase at the point where its marginal factor cost<sup>32</sup> meets its demand curve.<sup>33</sup> As the marginal outlay schedule—the monopsonist's equivalent to a marginal revenue curve—lies above the supply curve, the monopsonist purchases less than would a competitive buyer.<sup>34</sup> Accordingly, there is typically an output restriction in much the same way as in the monopoly context. Of course, the extent of the ensuing reduction depends on the price elasticity of supply.

Were output restriction in and of itself a ground for prohibition on antitrust grounds, the concerted exercise of monopsony power in an input market should be per se illegal. The question shall be asked *infra* as to whether such distortions in market outcomes ought to be condemned without further inquiry into the effect on downstream prices. Applying a literal consumer welfare requirement, however, the restriction in output must be linked to a consumer welfare loss in the form of higher prices. It is to this connection that we now turn.

#### B. MONOPSONY POWER GENERALLY HARMS CONSUMERS

Where firms collectively exercise monopsony power over input price upstream, and individually possess significant market power downstream,<sup>35</sup> it is likely that consumer harm will take place. This insight proves confusing for many.

It is misleading to assert that downstream sellers' reduced input costs will necessarily result in lower prices downstream and, hence, elevated levels of consumer welfare.<sup>36</sup> R. Hewitt Pate, speaking on behalf of the U.S. Department of Justice Antitrust Division, recently explained:

A casual observer might believe that, if a merger lowers the price the merged firm pays for its inputs, consumers will necessarily benefit. The logic seems to be that because the input purchaser is paying less, the input purchaser's customers should expect to pay less also. But that is not necessarily the case. Input prices can fall for two entirely different

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31. See, e.g., CARLTON & PERLOFF, *supra* note 6, at 107.

32. A monopsonist's marginal factor cost equals its marginal increase in cost in purchasing an additional unit. PERLOFF, *supra* note 7, at 522-23.

33. See, e.g., Roger D. Blair & Jeffrey L. Harrison, *Antitrust Policy and Monopsony*, 76 CORNELL L. REV. 297, 302-03 (1991).

34. *Id.*

35. Given the per se illegal status of seller-side concerted action over price, it is assumed here that no such downstream concerted action will take place.

36. See Blair & Harrison, *supra* note 33, at 303-07; Marius Schwartz, Economics Director of Enforcement, Antitrust Div., U.S. Dept. of Justice, Buyer Power Concerns and the Aetna-Prudential Merger, Address Before the 5th Annual Health Care Antitrust Forum, Northwestern University School of Law, at 3-5 (Oct. 20, 1999) (transcript available at <http://www.usdoj.gov/atr/public/speeches/3924.pdf>).

reasons, one of which arises from a true economic efficiency that will tend to result in lower prices for final consumers. The other, in contrast, represents an efficiency-reducing exercise of market power that will reduce economic welfare, lower prices for suppliers, and may well result in higher prices charged to final consumers.<sup>37</sup>

Nevertheless, Mr. Pate declined to explain how lower input costs may in fact lead to higher prices for consumers. It is important to identify the reason for reduced input costs leading to higher prices downstream, for recognition and comprehension of it has proved elusive for some courts. Marius Schwartz, again speaking on behalf of the Department of Justice, provided a more complete explanation, positing that "if input price falls because of the exercise of increased monopsony power by the merged firm, the input quantity utilized will typically fall. This induces the firm to cut its output of the good it sells to consumers and raise its price."<sup>38</sup>

The key to understanding how consumers may be rendered worse off, then, is marginal cost. Monopsonists' downstream marginal costs of production will likely go up due to a decrease in output. Why is this? It is because the reduced quantity of input, though purchased at a diminished per unit cost, will lead the monopsony-wielding firm to counteract the ensuing shortfall in supply by partially substituting another input for the monopsonized input. Importantly, however, this variable-proportions production substitution will not be efficient.<sup>39</sup> The result will be an elevated overall marginal cost of production. As profit-maximizing entities sell their goods at the point where marginal revenue equals marginal cost,<sup>40</sup> a higher marginal cost will lead to higher prices. Those higher prices will in turn lead to a diminution in output in the downstream market, clearly reducing consumer welfare. Accordingly, prohibition should follow where collusive oligopsonists' downstream marginal costs are elevated.

However, a number of critical assumptions underlie the above conclusion. The first is that significant market power exists in the downstream market. Where a firm has no market power, its unilateral decrease in output will not affect the market-clearing price. Accordingly, there will be no consumer harm. The second is that a reduction in the

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37. R. Hewitt Pate, Assistant Att'y Gen., Antitrust Div., U.S. Dept. of Justice, Statement Before the Senate Committee on the Judiciary Concerning Antitrust Enforcement in the Agricultural Marketplace, at 4 (Oct. 30, 2003) (transcript available at <http://www.usdoj.gov/atr/public/testimony/201430.pdf>).

38. Schwartz, *supra* note 36, at 6.

39. Given the assumption of profit maximization, we can be confident of the resulting inefficiency, for were the substitution efficient, it would already have taken place prior to the exercise of upstream monopsony power.

40. See CARLTON & PERLOFF, *supra* note 6, at 91. Note that the only exception to this profit-maximization rule lies in the oligopoly and oligopsony contexts. There, the profitability of a given price depends on the price being charged by other firms in the market. Accordingly, price being set according to the intersection of marginal revenue and marginal cost in this setting will not always be profit-maximizing.

quantity of the input sold in the upstream market will take place. Where the input elasticity of supply is perfectly inelastic, there will be no reduction in the quantity of input, no increase in marginal cost, and no consumer harm. The third is that there will be no pre-existing and overriding market power on the selling side in the upstream market. Moreover, where an upstream supply curve can be characterized as all-or-nothing—which arises where concerted oligopsony or monopsony power may dictate the quantity purchased, thereby forcing suppliers off their marginal cost curves to their average cost curves—no allocative inefficiency will take place, either upstream or downstream.<sup>41</sup>

The circumstances in which these foregoing assumptions break down will now be considered. Importantly, though, a showing that a business practice is not always harmful to consumer welfare is an insufficient ground for rejecting application of the *per se* standard. If the practice is incapable of carrying concomitant benefits, then the risk of a Type I error in applying the *per se* standard is reduced to zero. The worst possible outcome is that a business practice, the effect of which is neutral, is struck down. Crucially, though, there are circumstances in which concerted oligopsony power may elevate consumer welfare. These circumstances are addressed below.<sup>42</sup>

#### C. WHEN MARKET POWER DOES NOT EXIST DOWNSTREAM, CONSUMER WELFARE CANNOT BE HARMED

The fact that consumer harm cannot arise absent downstream market power is the first indication that *per se* treatment of concerted oligopsonistic conduct may be inappropriate. It may be possible for a group of firms to wield monopsonistic power upstream collectively, but to face competition downstream. What is the consequence of their joint exercise of purchasing power? The quantity of input purchased will decrease, as will the cost-per-unit. The unit reduction will typically lead the oligopsonists to have a higher downstream marginal cost of production. In setting their first-order condition for profit-maximization, then, a lower level of output will be produced. Critically, however, the competitive nature of the market will result in no effect on the market-clearing price. That being so, there will be no consumer harm.

It is interesting to observe that downstream competition will usually imply that the input elasticity of supply in the input market will be high. In other words, one can expect a showing of downstream competition to correlate with a lack of monopsony power upstream, as manufacturers of

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41. See generally C. Robert Taylor, Monopsony and the All-or-Nothing Supply Curve: Putting the Squeeze on Suppliers (June 2003), <http://www.auburn.edu/~taylocr/topics/market/supplycurve.pdf>. See also Part III.D, *infra*.

42. See *infra* Part II.E.

the relevant input will have many prospective purchasers for their produce.

Now, in a legal environment in which it is legal for purchasers to collude to lower the price for their inputs, it may be the case that the entire industry, competitive as it is downstream, will form a buyer-side cartel. In such circumstances, sellers in the input market may find themselves “locked-in” with no other sales avenues. At that time, monopsony power will exist and the quantity and price of the input will both likely decrease. The law’s per se prohibition of seller-side collusion would apply to prevent downstream concerted action with respect to the ultimate market-clearing price. Nevertheless, if the entire downstream market on the selling side enters into an upstream buyer-side cartel, each firm’s downstream marginal cost of production will rise due to the decrease in supply of the monopsonized input. Thus, each firm’s downstream price will rise. In short, even a competitive downstream market could experience a long-run price increase. Strangely, the downstream market would still be regarded as competitive if the price remained close to marginal cost, yet the higher levels of marginal cost would result in higher prices and lower output. This is precisely the kind of harm to which adherents of the Chicago School-defined consumer welfare standard would object.

Accordingly, the foregoing analysis begs the following crucial question: would a legal regime permitting collusive, oligopsonistic behavior in cases where downstream market power is lacking inadvertently lead to a long-run diminution in downstream competition? As described, the danger may be that upstream, collective monopsony power may lead to elevated downstream prices. Importantly, though, there are two reasons why such a fear is unwarranted.

First, even though each oligopsonist’s elevated marginal cost will lead it to raise prices, there will be an incentive for each firm to decline to participate in the upstream cartel so as to keep its marginal cost lower than its rivals. Although a decision not to avail itself of upstream monopsony power will have a short-run, profit-reducing effect, the oligopsonists’ ultimate ability to profitably charge a lower price downstream will enable them to take market share off their monopsony power-wielding rivals. In a one-shot game, every downstream seller would join the upstream cartel to increase its payoff. In a multi-period game, however, the higher expected return in period  $N + 1$  onward to be enjoyed by taking market share of rivals, discounted to present value, would likely exceed the reduced profits in the first period. As an extension of the same point, increased prices in the downstream market will create an avenue for rival firms to enter the market and contract with the upstream sellers on more reasonable terms to undercut the incumbents.

Second, such a situation would create a tremendously strong incentive for the upstream sellers to vertically integrate into the downstream market.

By doing so, they would be able to undercut the incumbent sellers and, again, take market share. Although the downstream market would ostensibly be characterized by competition, the incumbents' artificially high marginal costs would create a source of major competitive advantage to the vertically integrating firm. The risk of post-entry insolvency would, therefore, be low.

Crucially, then, the foregoing economic theory predicts that the exercise of monopsonistic pricing will be ephemeral. The transient nature of the practice accordingly renders unlikely the prospect that monopsony upstream will last long enough to have an appreciable effect on a competitive downstream market.<sup>43</sup>

Combining these points, it is somewhat unlikely that a competitive downstream industry will collectively engage in an upstream cartel for a prolonged period. Yet to the extent that competition would nevertheless be reduced, it is important to note that antitrust scrutiny of the upstream oligopsonistic cartel would then be sharply increased. When competition no longer exists downstream, or is appreciably diminished, the possibility of consumer harm exists and the monopsony-wielding cartel would be outlawed.

Accordingly, a showing of downstream market power should be legally required from the consumer welfare perspective in an antitrust suit against oligopsonist behavior.

#### D. MONOPSONY POWER SHOULD NOT APPRECIABLY RESTRICT OUTPUT WHERE THE INPUT ELASTICITY OF SUPPLY IS LOW

Where the input elasticity of supply in an upstream market is low, and in a context of perfect access to information, a concerted effort by oligopsonists to increase price will not entail a significant reduction in the quantity of input sold. As should be clear from the foregoing economic discussion, the reduction in output in the upstream market creates the various objectionable consequences of monopsony. The following discussion will explain the importance of input elasticity of supply.

In the short-run, seller lock-in may render supply perfectly inelastic at and above the average variable cost of production.<sup>44</sup> Short-term lock-in should not be unexpected, for it is an effective *sine qua non* for monopsony power to exist.<sup>45</sup> In such a case, there will be no short-term reduction in

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43. Supracompetitive profits caused by power on the buying side will generate entry in the long-run. Accordingly, the effects of monopsony will likely be transitory. *See, e.g., Easterbrook, supra* note 15, at 15.

44. It is profit-maximizing for a firm to continue selling in the short run, as long as price is higher than average variable cost. *See PERLOFF, supra* note 7, at 236-37. In the long run, pricing below average total cost leads to insolvency and exit from the market. *Id.* at 246.

45. Monopsony power is apt to exist only where the resource in question is uniquely valuable in its

output in the upstream market. Accordingly, inefficient intra-firm substitution in production need not take place and so downstream marginal costs in production will not rise. The collusive oligopsonists' costs will have fallen with no concomitant inefficiency. Indeed, this may facilitate lower prices downstream. The only sure short-run consequence is a wealth transfer from sellers to buyers. While this may be inequitable, it does not constitute consumer harm.

To appreciate how this outcome may arise, consider the following situation. A group of input manufacturers may produce enough inputs for the coming period. As the relevant inputs have only one use, and the cost to convert them into other products is more than the gap between the price offered by the monopsony cartel and the cost of selling to the cartel, all produced inputs will be sold. Thus, there will not be any immediate reduction in output.

Beyond the first period, supply will be more elastic. If purchasers force the price to below average variable cost plus the requisite markup to cover fixed cost—i.e., average total cost, which includes opportunity cost—sellers will exit the market in the second round and there will be a reduction in output in the upstream market. This will carry all the consequences leading to consumer harm described above, assuming the existence of downstream market power.

However, the oligopsonists will know this in advance and will not be so myopic as to force its suppliers out of the upstream market. Accordingly, oligopsonists acting in concert could be expected to set price at a level equal to the average total cost of the sellers in that market. In these circumstances, no output restriction will take place, for average total cost incorporates the opportunity cost of the sellers in employing their capital to produce the goods being purchased by the oligopsonists.

If the preceding observation were unreservedly true, the consumer welfare standard would require that concerted instances of monopsonistic control enjoy a *per se* standard of legality. Because no output-restriction would ever happen upstream, no consumer harm could follow downstream. Of course, and unfortunately, this is not the case.

The problem lies in the existence of information and inter-firm efficiency asymmetries. With respect to the former, even though the collusive monopsonists would like to set price equal to the average total cost of the upstream sellers, it will be prohibitively difficult for them to accurately pinpoint that relevant price. Of course, if the oligopsonists added a premium to the price they offered to purchase at, they would likely

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current use, so that even if the price is depressed by monopsony, sellers are unable to find alternative buyers. See RICHARD A. POSNER & FRANK H. EASTERBROOK, *ANTITRUST* 150 (2d ed. 1981).

succeed in keeping the price above the average total cost of their suppliers. They are more likely, however, to estimate downward, for in resolving ambiguities, the colluding oligopsonists will likely err on the side of lower prices, which increase their short-run profits.

The latter issue of inter-firm efficiency asymmetry merely accentuates the problem faced by colluding oligopsonists wishing to set price at the average total cost of the suppliers, for it is unlikely that any two firms operate under precisely identical cost functions. Accordingly, price discrimination would have to be exercised, which brings a plethora of its own difficulties.<sup>46</sup>

Thus, it can confidently be concluded that some output reduction in an upstream market is likely to occur in the long run, despite the best efforts of the oligopsony firms in question.

An important qualification remains, however. While a very low elasticity of supply tends to preclude allocative efficiency-based concerns, where price is successfully set equal to the sellers' average total cost, it does not follow that equitable considerations are not raised, for a monopsonist may be able to transfer much of sellers' wealth to itself. While this will not trigger antitrust concerns on the consumer welfare ground, a broader reading of antitrust harm may conclude otherwise.

#### E. THE POSSIBLE BENEFITS ASSOCIATED WITH CONCERTED MONOPSONY POWER

The foregoing discussion in this Part demonstrates the importance of there being actual monopsony power. Where no monopsony power exists—where the input elasticity of supply is high—no consumer harm can follow. Given the demonstrable danger that levels of monopsony power will be exaggerated,<sup>47</sup> it is essential to recognize this point. As will be seen, it is currently unclear whether courts applying the per se standard require such a showing as a prerequisite. Some cases may be read as exempting explicit cartels where sellers had alternative sales avenues,<sup>48</sup> which is the correct outcome from an economic perspective.

To go further, however, occasional lack of monopsony power may result in beneficial consequences. Conceivably, concerted behavior on the

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46. These not only include further information access issues, but finding and applying a mechanism by which to prevent arbitrage between sellers. See CARLTON & PERLOFF, *supra* note 6, at 294.

47. See, e.g., David Waterman, *Local Monopsony and Free Riders*, 8 Info. Econ. & Pol'y 337, 351-53 (1996), available at [http://www.indiana.edu/~telecom/faculty/waterman/monopsony\\_iep.pdf](http://www.indiana.edu/~telecom/faculty/waterman/monopsony_iep.pdf).

48. See, e.g., *Knevelbaard Dairies v. Kraft Foods, Inc.*, 232 F.3d 979, 1002 (9th Cir. 2000) (holding that plaintiffs failed to adequately show actual monopsony power on the part of defendants); *U.S. Healthcare Inc. v. Healthsource, Inc.*, 986 F.2d 589, 598 (1st Cir. 1993) (rejecting monopsony-based antitrust action against an HMO that purchased doctors' services because "doctors have too many alternative buyers for their services").

buyer side may enhance market outcomes and societal wealth in circumstances of ex ante monopoly power. This observation is of considerable importance in assessing whether to apply a per se standard to concerted monopsony over price, for until now it has not been shown how such concerted action may actually be beneficial, as opposed to merely benign. It is with this observation that the possibility of Type I errors is introduced for the first time in applying a per se approach.

In the case of pre-existing market power on the selling side, it is likely that a concerted effort on the part of purchasers may counteract the monopoly power and lead to a more efficient outcome. That the upstream market may be characterized by the existence of some form of seller-based market power ex ante suggests that instances of concerted oligopsonistic conduct in such a market may shift the market-clearing price closer to the competitive level.<sup>49</sup>

Should a buyer-side cartel be allowed to argue in defense that the prices being charged in the market were excessive? The answer is almost certainly not. Allowing firms to do so would not only be highly problematic in practice,<sup>50</sup> but would seem to contradict the well-established principle that seller-side cartels cannot argue that prices were too low.<sup>51</sup> Moreover, politically sensitive situations may arise, particularly in the employment context. For example, a group of employers, having been accused by employees of conspiring to depress wages, would be in a position to argue that the employees' legally granted market power in the form of trade union membership caused prices to be too high, thereby legitimizing their concerted conduct over price. Such a position, if legally recognized, would be more than somewhat perverse.<sup>52</sup>

49. Interestingly, at least one court has recognized such a possibility. In *Knevelbaard Dairies v. Kraft Foods, Inc.*, the Ninth Circuit observed:

If defendants managed to force the price floor down lower than it otherwise would be but that level was still *above* the price that would exist in a competitive market without any price supports, the lower price floor will simply allow mutually beneficial transactions that would not have occurred under the higher price floor. The lower price floor actually opens the market up more to the forces of competition.

232 F.3d, at 1003.

50. It is notoriously difficult for a court to judge whether a particular market price is at, below, or beyond the competitive level. See, e.g., Donald F. Turner, *The Definition of Agreement Under the Sherman Act: Conscious Parallelism and Refusals to Deal*, 75 HARV. L. REV. 655, 669 (1962) (noting the obviousness of the fact that courts are ill-suited to act as price regulators). This difficulty is exacerbated by the fact that any statements put forward by parties before the court will be non-credible.

51. See, e.g., *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150, 220-21 (1940).

52. It is unlikely, however, that such a right on the part of employers would be recognized. The Supreme Court has ostensibly applied a per se standard to the employment context. See *Anderson v. Shipowners' Ass'n*, 272 U.S. 359, 365 (1926) (holding that a shipowners' cartel organized for the purpose of suppressing wages paid to seamen violated the Sherman Act). Moreover, the Congressional grant of qualified antitrust immunity to trade unions increases the suspicion that employers would not be entitled to point to employee monopoly power. See *infra* text accompanying note 54.



Consider the case of the seller-side cartel first. In such a situation, buyer-power preceding the concerted conduct on the selling side of the market may lead to the latter improving efficiency. Yet the law properly refuses to entertain such claims. Why is this? The answer lies in the nature of the *per se* standard. Even where a seller-side cartel collectively possesses little market power, the resulting, elevated prices—short-lived as they will be, given the context of competition—will entail, at the least, a wealth transfer from consumers to sellers. In other words, concerted seller action is rarely, if ever, benign from a societal perspective. Most importantly, however, there is little or no possibility of a concomitant efficiency-gain. As concerted seller behavior almost invariably increases prices being charged to consumers, and pre-existing monopsony power will not typically exist and would entail the employment of scarce judicial resources to demonstrate, efficiency is justifiably enhanced by the *per se* rule; the probability of Type I errors is low.

Now consider the buyer-side cartel. Here, strict adherence to the consumer welfare standard renders concerted oligopsonistic behavior somewhat different. Consumer harm is more attenuated in this context and involves looking to more than one market. As there are numerous exigent circumstances, which do not arise with respect to seller-side cartels, that may render the practice benign from consumers' perspective, the law should be more amenable to expanding the level of judicial scrutiny. Nevertheless, the distinction does not seem sufficiently satisfactory to warrant the startling disparity between buyer- and seller-side cartels where the former may be allowed to argue that the prevailing prices were unfair but the latter may not.

Fortunately, there is an effective solution. Rather than argue that prices were unfairly high, buyer-side cartels ought to be allowed to argue that they did not, in fact, collectively possess or acquire monopsony power. Where the market is monopolized *ex ante*, an ensuing concerted exercise of buyer-side power will likely counteract that monopoly power, but will be unlikely to rise to monopsony levels. The courts have much experience in assessing business entities' market power, so requiring them to do so in the current context does not appear unreasonable. In short, there can be few easier ways for defendants to show that they do not possess market power than by pointing to monopoly power on the other side of the market. This is a far more workable defense than asking courts to become *de facto* price regulators by assessing whether defense arguments of high market prices were correct.

Would the employer in the above example be capable of defending a monopsony claim by pointing to the unionized nature of the seller-side of the market? The answer is probably not. First, Congress has expressly

exempted trade unions from antitrust scrutiny.<sup>53</sup> In essence, the legislative branch has recognized that some level of market power on the selling side of labor markets is desirable.<sup>54</sup> It is not at all clear that purchasers in the labor market should be entitled to use a legislative grant of market power to facilitate harm against the group Congress sought to protect.<sup>55</sup> Second, it will often be the case that employers will possess significant market power, notwithstanding the presence of trade unions. This will be particularly true in markets where there are few employers and a large number of prospective employees with relatively homogenous skills. In such heavily oligopolized markets, trade unions may actually shift the wage rate closer to the competitive level. In fact, such appears to motivate the legislative exemption of trade unions from antitrust liability: the Clayton Act was enacted, in part, to counteract the perceived exercise of monopsony power against employees, particularly through the use of injunctions.<sup>56</sup>

Nevertheless, were a market to exist in which there are many interested purchasers for a relatively small number of sellers, who are not unionized, and a considerable disparity in market power between the former and latter, the buyers may be entitled to point to the extent of ex ante monopoly power on the selling-side of the market. As expounded upon in Part III.D, *infra*, the courts may allow such a defense under the current law. It appears, though it is not certain, that the courts require some level of monopsony power in order for a violation of the Sherman Act to be found. It is certainly conceivable, however, that the employment context may provide a distinct setting where to recognize such a defense would

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53. Sections 6 and 20 of the Clayton Act have this effect. 15 U.S.C. §§ 17 and 52 (2000). Importantly, however, concerted action between unions and third parties are not exempted. See *Mine Workers v. Pennington*, 381 U.S. 657, 662 (1965).

54. See National Labor Relations Act, 29 U.S.C. § 151 (2000) ("The inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association substantially burdens and affects the flow of commerce, and tends to aggravate recurrent business depressions, by depressing wage rates and the purchasing power of wage earners in industry and by preventing the stabilization of competitive wage rates and working conditions within and between industries."); see also *Meat Cutters v. Jewel Tea Co.*, 381 U.S. 676, 723 (1965), *superseded by statute*, H.R. Rep. No. 72-669, at 10 (1932), *as recognized in* *Bhd. of Maint. of Way Employees v. Guilford Transp. Indus., Inc.*, 803 F.2d 1228 (1st Cir. 1986).

55. This point is far from academic, having been discussed by the Supreme Court. See *Brown v. Pro Football, Inc.*, 518 U.S. 231, 255 (1996) ("In light of the accommodation that has been struck between antitrust and labor law policy, it would be most ironic to extend an exemption crafted to protect collective action by employees to protect employers acting jointly to deny employees the opportunity to negotiate their salaries individually in a competitive market.") (Stevens, J. dissenting). Importantly, however, the *Brown* decision did not discuss the likely ramifications of employers colluding to depress wages where employees possessed vastly disproportionate market power. Justice Stevens did mention, however, that unique market characteristics may justify application of the rule of reason standard. *Id.* at 252.

56. See, e.g., *Allen Bradley Co. v. Local Union No. 3*, 325 U.S. 797, 802-03 (1945). See also text accompanying note 54, *supra*.

subvert legislative intent to confer a level of market power on trade unions.

Of course, if purchasers are allowed to point to pre-existing monopoly power as a defense to a monopsony claim, a disparity still exists; market power is not required for a seller-side cartel to be found illegal, but is required in monopsony cases.<sup>57</sup> Nevertheless, the distinction may be justified on the grounds that monopsony cases arise rarely and, when they do, there is less likelihood of consumer harm. On this ground, seller-side cartels that lack appreciable degrees of market power will quickly lose sales, but on the sales that do transpire there will be an unwarranted wealth transfer from consumer to seller. Buyer-side cartels that lack market power will not entail a wealth transfer from consumers, however, for no output restriction will take place upstream and so there will be no inefficient intra-firm input substitution in production, no higher marginal cost, and hence no price increase for the consumers downstream.

This foregoing discussion simply reinforces that a qualified *per se* standard of legality ought to be applied<sup>58</sup> in which market power on both the buying-side upstream and seller-side downstream must be demonstrated.<sup>59</sup>

#### F. THE SOCIAL LOSSES NOT ENCAPSULATED BY THE CONSUMER WELFARE STANDARD

The preceding analysis demonstrates that there are many situations in which consumer welfare considerations will not be triggered by concerted oligopsonistic behavior. Importantly, however, consumer-based effects are not the only possible grounds upon which to judge business practices.

Another, likely superior, foundational norm may involve looking to the process of competition itself. Price theory predicts that heightened levels of competition will lead to elevated levels of output, in addition to allocative and productive efficiency. From an economic perspective, then, any business practice that blunts the process of competition and causes a resulting instance of output restriction in a relevant market is objectionable. Where is the consumer in this analysis? Typically, the concept of such welfare is inversely correlated with the magnitude of deadweight loss in a market—as competition increases, so will output and thus deadweight loss will diminish. Accordingly, the output-expanding process of competition will lead to heightened levels of consumer welfare, other things being equal. Thus, the concept of consumer welfare harm may serve as a proxy

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57. Not only is this distinction justified on economic grounds, it appears to be the current law. *See infra* Part III.D.

58. This may be thought of as being akin to the modified *per se* rules covering tying arrangements, in which market power in the tying market and an appreciable impact on the tied market must be demonstrated. *See Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 461-62 (1992).

59. *See infra* Part IV.

for output restriction. Recognizing this clarifies the point that consumer harm should not be a prerequisite to antitrust harm where competition and output are reduced.

Adopting the aforementioned baseline of competitive harm—one that may be characterized as a “market distortion-based approach”—we will be far quicker to find harm in the context of monopsony pricing. The fact that consumers may not reside in an upstream input manufacturing market does *not* change the fact that it is a relevant market for antitrust purposes. Monopsony power, as we have seen, will usually curtail output. Sellers in that market will likely have the prices they can charge reduced to sub-optimal levels, leading them to produce less. As their products create value for society, net *societal* wealth will be reduced. As mentioned before, the reduced quantity of input will lead the oligopsonists or monopsonist to engage in inefficient substitution in production, entailing further wasteful expenditures. Even if no downstream market power exists, and consumers are not made worse off, deadweight loss follows from the monopsonistic control of price upstream.

In a very real sense, then, the concerted exercise of monopsony power reduces the level of competition in a relevant market. From the market distortion perspective, therefore, such concerted action should be deemed illegal. Moreover, the standards required of per se illegal status are met, except in the readily identifiable instance where the buyer-side cartel lacks monopsony power over price. As seen in Part III.E, *supra*, societal welfare may in fact be furthered by allowing concerted action by purchasers in a context of pre-existing power on the selling side. Since circumstances in which no monopsony power exists can be readily and effectively identified, they can be efficiently excluded from the per se rule. In sum, the risk of Type I errors is significantly reduced by applying per se illegality subject to the preliminary requirement of demonstrable monopsony power.

#### G. ECONOMIC CONCLUSIONS

Taking the strict variant of the consumer standard first, the key is to formulate a straightforward set of rules that will effectively and accurately dichotomize consumer welfare-reducing instances of buyer-side collusion and their benign counterparts. The key to this lies in the nature of downstream and upstream competition. Accordingly, a court seeking to implement this narrowly defined antitrust philosophy would find a buyer-side cartel objectionable only where the cartel succeeded in obtaining an appreciable level of monopsony power and where the cartel members possessed market power downstream. Long-run evidence of a lack of sellers exiting the market would imply that the market-clearing price is at least equal to the long-run average cost of the sellers and, thus, no output restriction is taking place. Such an insight may be used to support the argument that monopsony power is not being exercised in the market—or

that if it is, it is benign.

A broader inquiry of competitive harm, however, would concern itself with business practices leading to reduced levels of industrial output and allocative efficiency, for such consequences diminish overall societal wealth. From this perspective, a court need only look to whether the constituents of a buyer-side agreement collectively possess power over the price at which the relevant input clears. If they do, then the arrangement can be safely condemned, irrespective of downstream consumer harm.

To understand how these approaches differ in practice, let us return to query the hypothetical posed in the introduction. Interestingly, this simple example effectively operates to clearly distinguish the effects of a strict consumer welfare-devoted antitrust policy, on the one hand, and a market-distortion-based one, on the other.

From a strict consumer-welfare perspective, the exercise of concerted oligopsonistic power is laudable in this instance. This is a scenario in which there is a high level of downstream competition. Accordingly, the possibility of consumer harm is effectively precluded. The only possible obstacle would be raised in certain labor market cases. As this is not an employment case involving trade unions, in which legislative intent may preclude a defense of no consumer harm, consumer-focused courts would approve the agreement.

A broad market-distortion-based view of anticompetitive behavior, however, would condemn the above behavior on a *per se* basis, even though on these facts downstream consumer welfare will not be affected. As the cartel has reduced the market-clearing price to sub-optimal levels, a reduction in output will result. The agreement ought therefore to be struck down.

The divergence ceases to exist when the facts are altered slightly so that there is only a single seller in the market for the necessary input. Now the situation in which the four CEOs meet in an attempt to lower input costs is one of pre-existing market power on the seller side. By jointly combining their purchasing power, the four companies will lower the market-clearing price and elevate output, so long as their ensuing level of monopsony power does not outweigh the monopoly power. So construed, downstream prices will drop and consumer welfare will rise. Even from the market-distortion perspective, the buyer-side agreement should be legal insofar as the resulting power does not rise to monopoly levels.

In a very real way, this simple example highlights the divergence in the law between jurisdictions on this topic today. Some courts have been misled by the counterintuitive, though crucially important, insight that artificially lowered input costs upstream may cause prices to rise downstream. Other courts have adopted a strict variant of the consumer

welfare standard, according to which downstream market power is a prerequisite to illegality. These courts fail to appreciate that the foregoing standard serves as a generally accurate proxy for measuring the kind of harm that typically flows from artificially created market distortions. In the monopsony setting, that proxy may not be accurate.

Interestingly, though, it is not perfectly clear whether the courts have required actual monopsony power to exist. It is submitted that they should, and fortunately, such appears to be the more reasonable interpretation of the relevant jurisprudence in the field.

#### IV. THE COURTS' REACTION

Given the somewhat esoteric nature of the economic consequences of monopsony, it will be of little surprise to learn that the courts have failed to posit a consistent and coherent theory of competitive harm. The following discussion will demonstrate that the Supreme Court's say on the subject suggests, but does not unequivocally compel, a *per se* standard of illegality. The ensuing debate in the lower courts has focused on whether demonstrable consumer harm in downstream markets is an implied qualification with respect to the Supreme Court's ruling. Underlying the debate is a divergence between various courts with regard to the proper role of antitrust law. Those courts that require a showing of downstream market power appear to place determinative significance on the issue of consumer harm. In contrast, the majority of courts find the concerted exercise of monopsony power innately objectionable irrespective of the existence of consumer injury. According to the latter perspective, market distortions and injury to innocent sellers in monopsonized markets constitute valid and independent grounds for illegality.

A further, and highly important, question is whether the law requires an actual showing of monopsony power. The lower courts that have had the opportunity to clarify this issue have not done so. It will be suggested, however, that the more reasonable reading of the relevant case law suggests that oligopsonists must actually achieve a level of monopsony power for condemnation to follow.

##### A. THE SUPREME COURT'S INTERPRETATION

The Supreme Court last addressed the legality of collusive, monopsonistic conduct almost sixty years ago. In a 1948 decision, the Court held in no uncertain terms that a buyer-side conspiracy to reduce the price paid for a necessary input violates the Sherman Act.<sup>60</sup> There, California sugar producers colluded to suppress the price they had to pay

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60. *Mandeville Island Farms v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235 (1948).

for sugar beet.

The decision may fairly be interpreted as suggesting that per se illegality attaches to concerted instances of monopsonistic pricing.<sup>61</sup> Such is clear from the Court's opinion, which, in relevant part, stated:

It is clear that the agreement is the sort of combination condemned by the Act, even though the price-fixing was by purchasers, and the persons specially injured under the treble damage claim are sellers, not customers or consumers. . . . The statute does not confine its protection to consumers, or to purchasers, or to competitors, or to sellers. Nor does it immunize the outlawed acts because they are done by any of these.<sup>62</sup>

While it is reasonable to construe the judgment as requiring collusive monopsony to be treated as per se illegal, it is important to note that the judgment makes no explicit reference to consumer harm. However, the Court did state that "[t]he idea that stabilization of prices paid for the only raw material consumed in an industry has no influence toward reducing competition in the distribution of the finished product, in an integrated industry such as this, is impossible to accept."<sup>63</sup> This would seem to imply that the Supreme Court was concerned with downstream effects, at least to some degree.

Whether downstream consequences were viewed as the determinative issue or merely an additional ground supporting the finding of illegality is a critical question. Perhaps consumer harm was understood to exist or, alternatively, the Court may have found the upstream market distortion to be objectionable in and of itself. The Court's language may make the latter interpretation the more reasonable one. Justice Rutledge's holding made quite clear that the Sherman Act does not exist for the sole benefit of consumers.

This is an extraordinarily important aspect of the *Mandeville* judgment, for it would seem to render the economic analysis conducted in Part II redundant. If the antitrust laws unambiguously apply not only to protect consumers, but also market distortions negatively affecting market participants, then the foregoing economic investigation of when monopsony power will harm consumers is clearly defunct.

However, it is crucial to note that this decision took place long before the Chicago revolution of the late seventies through the eighties. Accordingly, given the current focus on the well-being of consumers, the U.S. Supreme Court could plausibly require a showing of consumer harm in oligopsony cases. Accordingly, the modern question may be whether the

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61. The Seventh Circuit has explicitly held so. See *Vogel v. Am. Soc'y of Appraisers*, 744 F.2d 598, 601 (7th Cir. 1984).

62. *Mandeville*, 334 U.S. at 235-36.

63. *Id.* at 241.

Court properly implied the existence of downstream consumer harm in *Mandeville*.

An additional issue is whether actual monopsony power was a formal requirement for the Court or whether any buyer-side cartel is illegal. Given the importance of this question, it shall be considered in Part III.D, *infra*.

#### B. THE MINORITY APPROACH

Although a majority of jurisdictions to consider the question of monopsony have interpreted *Mandeville* as importing a per se standard of illegality, a number of courts have nevertheless construed concerted monopsonistic behavior in a benign manner where there is no downstream market power.

In *Addamax Corp. v. Open Software Foundation, Inc.*, the U.S. District Court for the District of Massachusetts considered a motion for summary judgment taken by defendant purchasers accused of conspiring to lower prices.<sup>64</sup> In doing so, the court had to assess whether the plaintiff seller had antitrust standing; that is, injury of the type the antitrust laws were intended to prevent.<sup>65</sup> It was held that business losses to the plaintiff alone would not suffice. Rather, antitrust injury “occurs when the colluding buyers possess market power on a downstream market. Only with control of a downstream market can the monopsonist decrease output and raise price.”<sup>66</sup> As there was an adequate allegation of market power, the court found the requisite standing.

This decision is arguably inconsistent with the Supreme Court’s decision in *Mandeville*, though, as noted, the latter case did not refer to consumer harm. Interestingly, the *Addamax* decision reflects a recognition of the economic fact that consumer welfare cannot be diminished without some level of corresponding downstream market power. Accordingly, the court can be seen applying a strict variant of the consumer welfare standard. Of course, were a more expansive definition of consumer harm to be employed, the District of Massachusetts’ requirement of downstream power would be erroneous for legitimizing certain monopsonistic practices which, although not adversely affecting the market-clearing price downstream, do reduce output in upstream markets, disrupt the normal operation of market forces, and harm upstream sellers.

The U.S. District Court for the Western District of New York has expressed a similar opinion. In *Kamine/Besicorp Allegany L.P. v.*

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64. *Addamax Corp. v. Open Software Found., Inc.*, 888 F. Supp. 274, 276 (D. Mass. 1995).

65. *See Brunswick Corp. v. Pueblo Bowl-O-Mat, Inc.*, 429 U.S. 477, 489 (1977).

66. *Addamax*, 888 F. Supp. at 280.



*Rochester Gas & Electric Corp.*, the court held: "The problem with this type of monopsony power, then, is that ultimately it can injure consumers by forcing up the price of the end product. Where the risk of that happening is slight or nonexistent, however, monopsony power per se does not create an antitrust concern."<sup>67</sup>

Again, the court can be seen as employing a narrow version of the consumer welfare standard. As explained below, however, other courts to consider the issue have construed the spectrum of competitive harms on a broader basis.

### C. THE MAJORITY APPROACH

The weight of authority clearly counsels for per se prohibition of concerted oligopsonistic control over price.<sup>68</sup> Intriguingly, then, the majority position appears to reflect a market-distortion perspective, according to which consumer harm is not the ultimately relevant factor. As monopsony power reduces output in a relevant product market, albeit one in which consumers do not reside, it is properly condemned according to this view.

Representatively, the Tenth Circuit recently held in *Telecor Communications, Inc. v. Southwestern Bell Telephone Co.* that the "unmistakable import of the case law" compels the conclusion that "suppliers . . . are protected by antitrust laws even when the anti-competitive activity does not harm end-users."<sup>69</sup> The Tenth Circuit clearly viewed the *Addamax* and *Kamine* cases as outliers that were out of touch with the weight of authority.<sup>70</sup>

The D.C. Circuit has espoused a similar view, holding that "market inefficiencies created by anticompetitive restraints on input markets can be as destructive of a free market economy (and therefore ultimately damaging to consumers) as restraints on output markets."<sup>71</sup> In addition, the Seventh Circuit has construed concerted monopsony pricing as being

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67. *Kamine/Besicorp Allegany L.P. v. Rochester Gas & Elec. Corp.*, 908 F. Supp. 1194, 1203 (W.D.N.Y. 1995).

68. See, e.g., *Am. Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946) (holding that antitrust law can apply to input, as well as output, markets); *Mandeville Island Farms v. Am. Crystal Sugar Co.*, 334 U.S. 219, 243 (1948) (strongly implying a per se standard of illegality); *Vogel v. Am. Soc'y of Appraisers*, 744 F.2d 598, 601 (7th Cir. 1984) (applying a per se standard); *Reazin v. Blue Cross & Blue Shield of Kan., Inc.*, 899 F.2d 951, 962 (10th Cir.1990) (rejecting a defense argument that lack of harm to consumers precludes the existence of antitrust injury); *United States v. Syufy Enters.*, 903 F.2d 659, 663 (9th Cir. 1990) ("[I]t is theoretically possible to have a middleman who is a monopolist upstream but not downstream . . .").

69. *Telecor Commc'ns, Inc. v. Sw. Bell Tel. Co.*, 305 F.3d 1124, 1133-36 (10th Cir. 2002).

70. *Id.* at 1133-36.

71. *Brown v. Pro Football, Inc.*, 50 F.3d 1041, 1061 (D.C. Cir. 1995).

equivalent to seller-side cartels and accordingly illegal per se.<sup>72</sup>

Clearly, the majority of courts has rejected the strict consumer welfare approach and has instead adopted the position that output restriction within a relevant market is sufficiently objectionable to warrant prohibition. The remaining question is whether the majority standard is likely to permeate into, and be accepted by, the minority jurisdictions. It is the hope and expectation of this Article that it will.

#### D. IS AN ACTUAL SHOWING OF MONOPSONY POWER REQUIRED?

The cases in which the courts have condemned buyer-side cartels have all involved the existence of actual monopsony power. This begs the necessary question of whether a showing of such power is a *sine qua non* for violation of the antitrust laws.

The Supreme Court in *Mandeville* placed great emphasis on the fact that monopsony power did, in fact, exist.<sup>73</sup> Given this focus, it is an open question as to whether the Court would have deemed the arrangement illegal had it involved only a small percentage of the buyer-side of the market. Consideration of other case law furthers the inference that buyer cartels are not illegal until the buyers collectively possess market power.

The Tenth Circuit in *Telecor* construed the *Mandeville* decision as turning, in part, on the effectiveness of “the sugar refiners’ monopsonistic price-fixing scheme” due to the fact that “growers could not easily find other buyers or profitably switch to other crops when refiners conspired to fix the price of sugar beets.”<sup>74</sup> In addition, the D.C. Circuit opined that “restraints on input markets arise *only* in the unusual circumstance of an effective monopsony.”<sup>75</sup> Where no monopsony power follows concerted buyer behavior, no restraint in the input can result. Accordingly, then, the D.C. Circuit might not find such an outcome objectionable.

The Second Circuit’s analysis in *Todd v. Exxon Corp.* strongly suggested that a showing of market power is required.<sup>76</sup> In conducting an examination of the buyer side of the market, the court noted the importance of the fact that “a greater availability of substitute buyers” will result in “a smaller quantum of market power on the part of the buyers in question.”<sup>77</sup> Such a discussion would be essentially redundant but for the significance a

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72. See *Khan v. State Oil Co.*, 93 F.3d 1358, 1361 (7th Cir. 1996), *vacated*, 522 U.S. 3 (1997); *Vogel*, 744 F.2d at 601.

73. *Mandeville Island*, 334 U.S. at 223-24 (emphasizing that all purchasers in the relevant market were privy to the seller-side cartel and that the sugar beet producers were effectively locked-in, which of course facilitated monopsony power).

74. *Telecor*, 305 F.3d at 1133-36.

75. *Brown*, 50 F.3d at 1061 (emphasis added).

76. *Todd v. Exxon Corp.*, 275 F.3d 191, 202 (2d Cir. 2001).

77. *Id.*

lack of market power would have on the buyer-side cartel claim. Relevantly, no such analysis would be undertaken in a § 1 action under the Sherman Act against seller-side cartels—the only issue would be whether the constituent firms entered into a price agreement.<sup>78</sup> Accordingly, the courts' treatment of monopsony cases is noticeably different from the market power perspective.

Economic theory predicts that buyer-side collusion failing to yield market power should not be held illegal. In addition, it is important to note on a pragmatic level that applying a pure *per se* rule—one not requiring market power—would yield absurd results. For instance, if a person agrees with his friends not to purchase from a local shop until it lowered its prices, would that be illegal? The question does not survive its asking. For all these reasons, monopsony power should be a prerequisite to a § 1 action in this sphere. Encouragingly, the major judicial decisions in the area appear to mirror the foregoing economic theory and pragmatism. A definitive judicial determination as to this question would, nonetheless, be most valuable.

## V. CONCLUSION

This Article has attempted to unravel the somewhat arcane economic process by which concerted monopsony power is capable of leading to consumer harm. It has been shown that some form of both monopsony power upstream and monopoly power downstream is required for consumer welfare to be diminished. Yet, only the former requirement is necessary for output restriction to take place in an economically relevant product market. The distinction creates an inherent tension that can only be reconciled by the adoption of a clear competitive standard.

The resulting question raised by this Article is whether the consumer welfare standard should be interpreted in the strict manner advocated by some. It has been shown that there are many instances in which the exercise of upstream monopsony power will not be harmful to consumers. Accordingly, adherence to the consumer welfare model does not lead easily to *per se* condemnation. Yet, something seems perverse about an antitrust rule—even one applied on a qualified basis—that would allow firms to explicitly collude, significantly alter the price at which the relevant market clears, and harm the sellers residing therein.

Perhaps the better way to approach antitrust questions is not through the lens of consumer welfare, narrowly defined, but rather from the perspective of market distortions. According to the latter paradigm, concerted deformation of market processes may be objectionable in and of

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78. See, e.g., *United States v. Trenton Potteries Co.*, 273 U.S. 392, 398 (1927) (holding that minimum, horizontal price-fixing is illegal *per se*).

itself. Such a standard would inarguably comport with the Supreme Court's antitrust jurisprudence, which has spoken not so much of consumer welfare, but of protecting the process of competition. It is unquestionably the case that the Court has viewed the vigorous process of competition itself as the most sacrosanct concern of the antitrust laws.<sup>79</sup> The debate now is whether "the process of competition" that is to be protected involves a consumer welfare prescription, an aggregate welfare norm, or some other guiding principle. The more modern focus on consumer welfare, introduced by the Chicago School, resonates well with the goal of protecting the competitive process, for the latter will generally promote the former. Nevertheless, it remains uncertain as to whether the Court would define the consumer welfare imperative in so narrow a way as to render legally innocuous explicit instances of competition being suppressed by colluding purchasers.

From the market-distortion perspective, then, concerted monopsony power clearly eliminates competition on the buyer side of the market, and absent some countervailing consideration, such as the *ex ante* existence of seller-side monopoly power in the same market, clearly qualifies for the per se standard. In addition to some courts, the Department of Justice has ostensibly adhered to a market-distortion standard in analyzing cases of monopsony.<sup>80</sup> Particularly pertinent on this ground—and illuminative on the question of the future definition of consumer welfare—are the recent comments of Marius Schwartz, speaking for the U.S. Justice Department:

Should antitrust be concerned with monopsony mergers which reduce welfare but do not harm consumers? An objection I've heard is that "antitrust protects consumers not competitors." In my view, however, this phrase should not be read literally as saying that only consumers matter. It is a metaphor for saying that antitrust is concerned not with individual competitors but with the competitive process. So if a merger increases market power and thereby harms the firm's trading partners—customers *or* suppliers—by more than it benefits the firm, antitrust concern *is* warranted. Insisting on consumer harm is overly narrow.<sup>81</sup>

Nevertheless, the consumer welfare standard has much to commend it. Artificially created market distortions almost invariably harm consumers and the latter constitutes a very close proxy for the former. Focus on the consumer enables courts to effectively dissect the cases before them and to

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79. See, e.g., *Gordon v. N.Y. Stock Exch., Inc.*, 422 U.S. 659, 689 (1975) (holding that "the sole aim of antitrust legislation is to protect competition" without mentioning consumer welfare); *id.* at 692 (the "antitrust laws are designed to safeguard a strong public interest in free and open competition . . ."); (Douglas, J., concurring); *Silver v. N.Y. Stock Exch.*, 373 U.S. 341, 359 (1963) ("[T]he antitrust laws serve, among other things, to protect competitive freedom . . ."); *Mandeville Island Farms v. Am. Crystal Sugar Co.*, 334 U.S. 219, 235-36 (1948) (explicitly holding that the Sherman Act protects more than consumers).

80. See, e.g., Pate, *supra* note 37.

81. Schwarz, *supra* note 36.

avoid mistaking harm to individual competitors—a consequence of both competition-enhancing and competition-reducing business practices—for harm to the competitive process. Given the frequency with which the Supreme Court has made this mistake,<sup>82</sup> this benefit of the consumer standard is not to be underestimated.

If, however, the consumer welfare standard is to be applied in its literal form, the logical consequences of its application must be accepted, even in draconian circumstances. Accordingly, instances of firms explicitly entering into buyer-side cartels and curtailing output in an upstream market must be regarded as benign where downstream market power is lacking. Thus, if the courts are to hold to the standard they proclaim, a modified *per se* approach—akin to that now employed in the product-tying context—must be utilized.

Until the Supreme Court has occasion to revisit the question of concerted monopsony power, or until the minority jurisdictions accept the sound economics behind the majority approach, a tension will continue to persist within this area of law. The unresolved question will be whether courts should be compelled to highlight demonstrable consumer harm in monopsony cases or to simply condemn such cases where market distortions arise. Both the Supreme Court historically,<sup>83</sup> and the U.S. Department of Justice recently,<sup>84</sup> have spoken of the antitrust laws being applied for more than consumers alone. If such is to be the case for the future, the ostensibly exclusive focus on consumer welfare in other contexts must be reconsidered for overall coherence in the field of antitrust law. The key to this is explicit recognition of the fact that the concept of consumer welfare serves as a mere proxy for efficient, output-maximizing market outcomes.

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82. See, e.g., BORK, *supra* note 4, at 427 (discussing the erroneous manner in which the Supreme Court has construed various business practices as malign, even when they in fact furthered the competitive process and elevated consumer welfare); see also POSNER, *supra* note 29, at 20 (same).

83. *Mandeville Island*, 334 U.S. at 219.

84. See Pate, *supra* note 37.